# R60H
# College Savings Plans of Maryland

## *Operating Budget Data*

**($ in Thousands)**

| | FY 12 Actual | FY 13 Working | FY 14 Allowance | FY 13-14 Change | % Change Prior Year |
|---|---|---|---|---|---|
| Nonbudgeted Fund | $2,262 | $3,010 | $3,129 | $119 | 3.9% |
| **Adjusted Nonbudgeted Fund** | **$2,262** | **$3,010** | **$3,129** | **$119** | **3.9%** |
| **Adjusted Grand Total** | **$2,262** | **$3,010** | **$3,129** | **$119** | **3.9%** |

- For fiscal 2014, the College Savings Plan of Maryland (CSPM) expects expenditures to increase $0.1 million, or 3.9%, over fiscal 2013.

## *Personnel Data*

| | FY 12 Actual | FY 13 Working | FY 14 Allowance | FY 13-14 Change |
|---|---|---|---|---|
| Regular Positions | 15.00 | 18.00 | 18.00 | 0.00 |
| Contractual FTEs | 0.00 | 0.00 | 0.00 | 0.00 |
| **Total Personnel** | **15.00** | **18.00** | **18.00** | **0.00** |

***Vacancy Data: Regular Positions***

| | | |
|---|---|---|
| Turnover and Necessary Vacancies, Excluding New Positions | 0.00 | 0.00% |
| Positions and Percentage Vacant as of 12/31/12 | n/a | n/a |

Note: Numbers may not sum to total due to rounding.

For further information contact: Sara J. Baker Phone: (410) 946-5530

# *Analysis in Brief*

## Major Trends

***Continued Growth in Accounts and Unique Holders:*** The number of accounts grew 7.8% to 203,017 in fiscal 2012, of which 61.0% were unique account holders.

***Sustained Enrollment Growth and Use of Trust:*** Growth in the trust slowed from 5.9% in fiscal 2010 to 2.4% in fiscal 2012, while the number of students in the plan increased 11.6%. The number of students attending a Maryland public institution using the trust increased 11.9% in fiscal 2012.

## Issues

***Few Families Participate in 529 Plans:*** According to a recently released U.S. Government Accountability Office report, less than 3% of families had a 529 plan. Those that participated had about 25 times the median financial assets and a median income about three times those who did not participate in a plan. This is a trend that holds true in Maryland in which the highest participation rates occurred in those counties with higher median income.

***Actuarial Surplus Increases:*** In fiscal 2011, the surplus significantly increased from $2.5 million in fiscal 2010 to $122.3 million, and the trust was 117.0% funded. This growth was due to an overall return of 21.0% on the trust's investments compared to 7.65% return in fiscal 2010.

***Still No Brokerage Backed Plan:*** Chapter 548 of 2008 allows CSPM to establish the Maryland Broker-Dealer College Investment Plan allowing families who invest through private investment advisors to participate in one of the CSPM plans. To date, no progress has been made toward establishing a broker plan.

## Recommended Actions

1. Nonbudgeted.

# Operating Budget Analysis

## Program Description

The College Savings Plans of Maryland (CSPM) offers the Maryland Prepaid College Trust and the Maryland College Investment Plan, providing a variety of affordable and flexible options to encourage saving for a child's college education. CSPM is an independent agency, established during the 1997 legislative session (Maryland Annotated Code, Education Article, Section 18-1901 through 18-1916 and 18-19A-01 through 18-19A-07). A 10-member board administers the trust and oversees the administration of the plan. Five board members serve by virtue of the State office they hold including the State Treasurer, the State Comptroller, the Secretary of the Maryland Higher Education Commission, the State Superintendent of Schools, and the Chancellor of the University System of Maryland. The Governor appoints the 5 remaining members.

Both plans are also know as 529 plans after the section in the Internal Revenue Code that permits states to establish and administer tax-deferred college savings plans. Both plans offer federal and State tax benefits including:

- federal and State taxes deferred on growth;
- federal and State tax-free earnings, provided funds are used for eligible college expenses; and
- State income deduction of contributions to one or both plans up to $2,500 annually per account or beneficiary. Excess annual contributions over $2,500 may be carried forward and deducted in future years.

### Maryland Prepaid College Trust

The Maryland Prepaid College Trust allows participants to lock in a current price for future college tuition benefits and is backed by the Maryland Legislative Guarantee. The guarantee requires the Governor, in instances when the current prepaid contract obligations exceed the market value of the trust assets, to include in the annual budget an appropriation in the amount needed to cover the shortfall. The appropriation would then require approval of the General Assembly. Furthermore, if the State appropriation is less than the amount needed for the trust to meet its current obligations, the CSPM board may adjust the terms of subsequent or current contracts to ensure continued actuarial soundness of the trust.

Participation is open to Maryland and District of Columbia residents. Additionally, people living out-of-state but applying for a child residing in Maryland or the District of Columbia are eligible to participate in the trust. Enrollment is open to children from newborns through grade 12, but an account must be opened for at least three years before payment of benefits. The enrollment period is generally from December to April, but newborns may be enrolled year round until their first birthday.

Participants enter into a contract with the trust for payment of tuition and mandatory fees for a specified amount of time. Account holders can purchase one or two years of community college; one semester or one to five years of a four-year university; or two years of community college and two years of a four-year university. For a child enrolled in a Maryland public college, the trust will pay full in-state or in-county tuition and mandatory fees to the college. If a child attends an eligible private or out-of-state college, the trust will pay up to the weighted average tuition and mandatory fees of Maryland public colleges. Account holdlers may also be eligible for a minimum benefit which equals the amount of their payments to the trust plus a resonable rate of return that is tied to a treasury index. This rate of return has been zero since October 2008. There are four payment options: lump sum, annual, five-year monthly, and extended monthly. For example, the contract price for an infant enrolled in the four-year university plan is

- lump sum = $41,298;
- annual = $4,076 (17 payments);
- five-year monthly = $827; or
- extended monthly = $361 (204 payments).

During the 2011-2012 enrollment period, there were approximately 2,472 new enrollments, an increase from 2,352 during the 2010-2011 enrollment period. Infants comprised the largest group at 15% of new enrollments, and the four-year university plan was the most popular enrollment option with 34% of new enrollments choosing this option. For the fall 2012 semester and as of October 21, 2012, of the 9,381 students eligible to use benefits, approximately 57%, or 5,347 students, claimed benefits. Of those claiming benefits, 44%, or 2,353 students, are attending a Maryland public institution, compared to 40% for the fall 2011 semester, while the rest attended a private or out-of-state college.

As of September 30, 2012, the value of the trust was $718.9 million.

## Maryland College Investment Plan

The Maryland College Investment Plan, which functions similarly to a 401(k) plan, provides more flexibility, and the funds may be used at any eligible college or trade school. Participants select among eight enrollment-based and six fixed investment portfolios, managed by T. Rowe Price, with automatic contributions starting at $25 a month. Under the plan, participants generally take on greater risk in exchange for the possibility of greater returns. Currently, the Internal Revenue Service allows participants to move or transfer funds from one investment portfolio to another once a year. The plan began in December 2001 and is open to children or adults of any age. Enrollment is open year round, and investors may choose how much and how often they wish to contribute.

Contributions and investment earnings are available for qualified higher education expenses including tuition, fees, room and board, and other expenses defined by Section 529 of the Internal Revenue Code. The plan is not guaranteed by the State.

Over 66% of the beneficiaries are under nine years old with approximately 47% of those age four or under at the time of enrollment. Trends in investment selections show the enrollment-based portfolios, in which investment mixes automatically adjust to be more conservative over time, continue to be a popular choice with Portfolio 2027 comprising 18% of the new accounts.

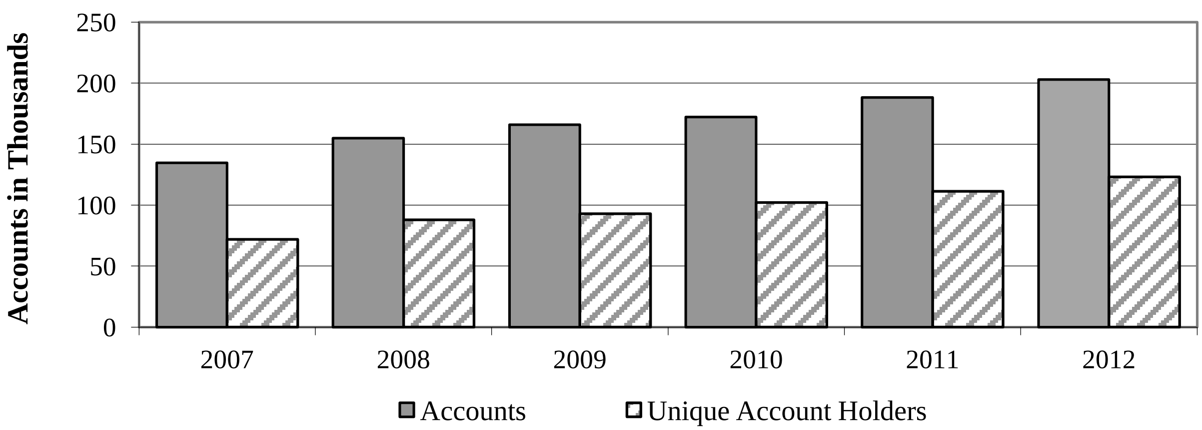
As of October 31, 2012, assets in the plan equaled $2.8 billion.

## Performance Analysis: Managing for Results

### 1. Continued Growth in Accounts and Unique Holders

A goal of CSPM is to create and maintain statewide awareness of the plan which is reflected in the total number of accounts and the number of unique account holders as shown in **Exhibit 1**. Overall, since fiscal 2007, the number of accounts has increased 50.8%, or 68,417 accounts. The effects of the economic recession can be seen in fiscal 2009 and 2010, when the rate of new accounts slowed to 7.2 and 3.6%, respectively, for a three-year average of 13.6%. Conversely, the 9.4% growth in the number of accounts in fiscal 2011 reflects an improving economy as people have money to put aside for their children's education. Growth continued in fiscal 2012 at a rate of 7.8% to a total of 203,017 accounts.

**Exhibit 1**
**Number of Accounts and Unique Account Holders**
**Fiscal 2007-2012**



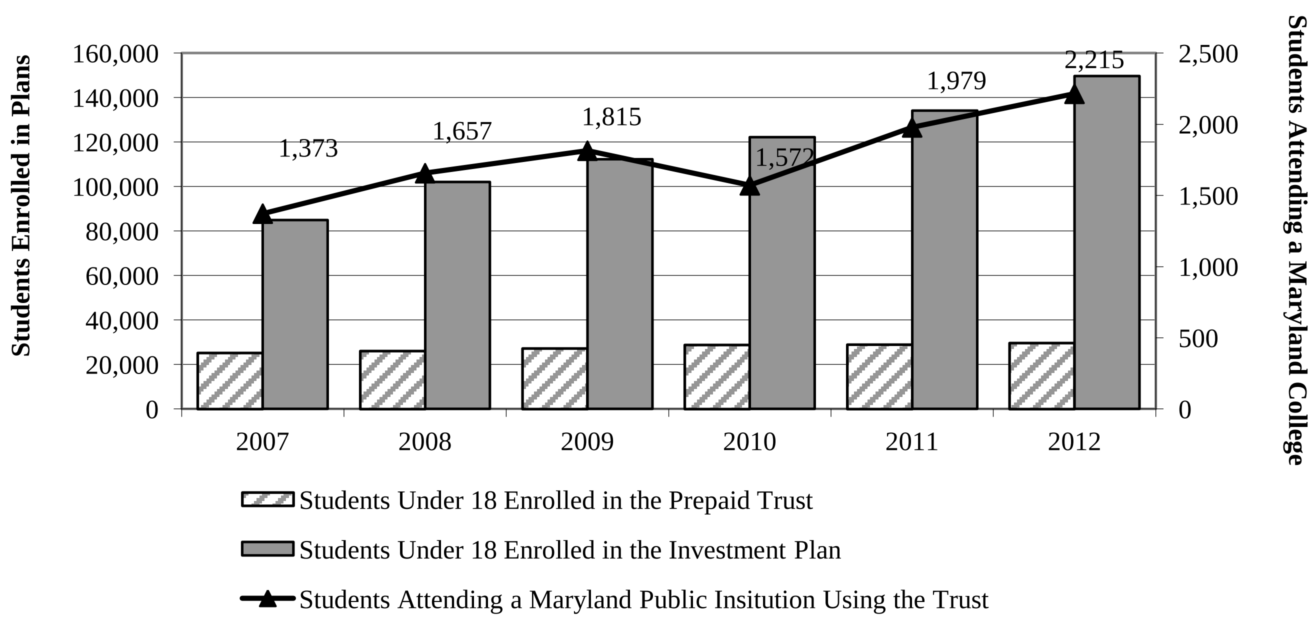

Source: College Savings Plan of Maryland, Governor's Budget Books, Fiscal 2014

The number of unique account holders has grown 70.2%, or 50,983, since fiscal 2007. On average, the number of unique account holders comprised 56.9% of accounts, reflecting the investment strategy of some participants to take advantage of the various options and benefits offered by the plans.

## 2. Sustained Enrollment Growth and Use of Trust

CSPM offers families many options to save for their children's college education and reduce reliance on loans to pay for college. **Exhibit 2** shows the number of students under the age of 18 enrolled in the prepaid trust and investment plan and students attending Maryland public institutions using the trust to pay for college. Enrollments in the prepaid trust grew at a moderate rate averaging 3.4% since fiscal 2007. However, since fiscal 2011, the rate of growth has slowed considerably from 5.9% in fiscal 2010 to 0.7 and 2.4% in fiscal 2011 and 2012, respectively. Meanwhile, enrollments in the investment plan continue to outpace that of the trust, increasing 76.1%, or 64,685 enrollments, since fiscal 2007 indicating participants' preference of the flexibility afforded by the investment plan. Enrollments in the plan slowed during the recession in fiscal 2009 and 2010 increasing 10.0 and 8.8%, respectively. Since fiscal 2010, enrollments accelerated, increasing 22.5%, or 27,505 enrollees, reflecting an economic recovery.

**Exhibit 2**
**Students Enrolled in Plans and Using the Prepaid College Trust**
**Fiscal 2007-2012**




Source: Governor's Budget Books, Fiscal 2014

After increasing 32.2% between fiscal 2007 and 2009, the number of students attending Maryland public institutions using the trust fell 13.4% in fiscal 2010. In fiscal 2012, only 1,572 of 4,745 students who claimed tuition benefits attended a Maryland public institution, indicating more students were attending private or out-of-state institutions. Since then, the number of students using the trust to attend a Maryland public institution increased to 2,215 students.

## Proposed Budget

CSPM revenues from the prepaid trust consist of enrollment fees, management fees, and other fees occasionally charged depending on the activity of the account holder. The enrollment fee structure is based on the method used to open an account: $75 for using the paper form; $50 for online enrollment; and $20 if purchasing an additional account or if rolling funds over from the investment plan. In addition, the trust charges 2.5% of all contract payments and a $4 payment processing fee for scheduled payment to cover operating expenses. As shown in **Exhibit 3**, fiscal 2013 revenues from trust enrollment fees are expected to decline 23.0% when compared to fiscal 2012. In fiscal 2012, CSPM began receiving payments from approximately 2,400 new enrollments that were received in fiscal 2011, but the initial payments were not due until August 1, 2011. Additionally, enrollments exceeded projections by 400 in fiscal 2012 with some choosing to make payments before the August 1 deadline. Revenues budgeted for fiscal 2013 and 2014 are based on a continued goal of 2,000 new enrollments and do not include estimates for early payments from account holders.

Revenues from the investment plan are projected to increase 10.6% in fiscal 2014. Revenues are based on the current contract which requires T. Rowe Price to pay CSPM an annual amount equal to the greater of (1) $636,000 or (2) 0.04% of the average monthly net assets of the plan when assets are between $750.0 million and $1 billion and an additional 0.06% of average plan assets greater than $1 billion. In fiscal 2012, the plan's assets exceeded $2 billion resulting in payment of $2.1 million. Total revenues from both plans are expected to be $3.7 million in 2014, an increase of 7.7% over fiscal 2013.

In fiscal 2013, expenses for communications increased 114.5%, or $81,134, reflecting the projected cost of a new call center contract to answer calls and take messages for current account holders in the trust. The software license fee jumps 105.1%, or $36,064, which is the agency's estimated increase in cost for various State software licenses *e.g.*, Microsoft Office, which expired in October 2012. Expenses for fiscal services, which include actuarial services; independent audit; banking; financial advisor; database host; records administration; and disaster recovery, increased 43.6%, or $221,656, due to unusually low expenditures in fiscal 2012. This was primarily due to the delay of two searches for assets managers until the completion of an asset allocation study and lower than anticipated usage of software development and support. Salaries, wages, and fringe benefits increased $346,740 in fiscal 2013 due to the addition of 3 positions: a compliance/account holder support manager, an accountant to answer telephone calls from trust account holders, and an administrative assistant. In fiscal 2014, office equipment increases $70,000, due to the purchase of two database servers required for future upgrades to the records administration software.

## Exhibit 3
# College Savings Plans of Maryland Revenues and Expenditures
### Fiscal 2012-2014

| | 2012 | Estimated 2013 | % Increase 2012-2013 | Estimated 2014 | % Increase 2013-14 |
|---|---|---|---|---|---|
| **Revenues** | | | | | |
| **Prepaid Trust** | | | | | |
| Enrollment Fees | $108,000 | $83,200 | -23.0% | $83,200 | 0.0% |
| Management Fees | 1,634,000 | 1,315,000 | -19.5% | 1,362,000 | 3.6% |
| **Total** | **$1,742,000** | **$1,398,200** | **-19.7%** | **$1,445,200** | **3.4%** |
| **Investment Plan** | | | | | |
| Program Contributions | 1,853,000 | 2,070,000 | 11.7% | 2,289,000 | 10.6% |
| **Total** | **$1,853,000** | **$2,070,000** | **11.7%** | **$2,289,000** | **10.6%** |
| **Total Revenues** | **$3,595,000** | **$3,468,200** | **-3.5%** | **$3,734,200** | **7.7%** |
| **Expenditures** | | | | | |
| Salaries, Wages, and Fringe Benefits | $1,170,305 | $1,517,045 | **29.6%** | $1,525,183 | 0.5% |
| Communication | 70,866 | 152,000 | **114.5%** | 156,560 | 3.0% |
| Travel | 12,229 | 12,000 | **-1.9%** | 12,000 | 0.0% |
| Fiscal Service | 508,344 | 730,000 | **43.6%** | 750,000 | 2.7% |
| Contractual Services – Marketing | 217,307 | 241,493 | **11.1%** | 248,738 | 3.0% |
| Supplies and Materials | 34,586 | 35,078 | **1.4%** | 36,130 | 3.0% |
| Office Equipment | 27,344 | 27,500 | **0.6%** | 97,500 | 254.5% |
| Fixed Charges | 175,000 | 211,487 | **20.8%** | 215,039 | 1.7% |
| Other Expenses | 11,428 | 13,460 | **17.8%** | 13,460 | 0.0% |
| Software License Fee | 34,330 | 70,394 | **105.1%** | 74,600 | 6.0% |
| **Total Expenditures** | **$2,261,739** | **$3,010,457** | **33.1%** | **$3,129,210** | **3.9%** |
| **Excess Revenues** | **$1,333,261** | **$457,743** | **-65.7%** | **$604,990** | **32.2%** |

Note: The prepaid trust and the investment plan each have a fund for excess revenues. The revenues may only be used to benefit the families that participate in the plans.

Source: College Savings Plans of Maryland

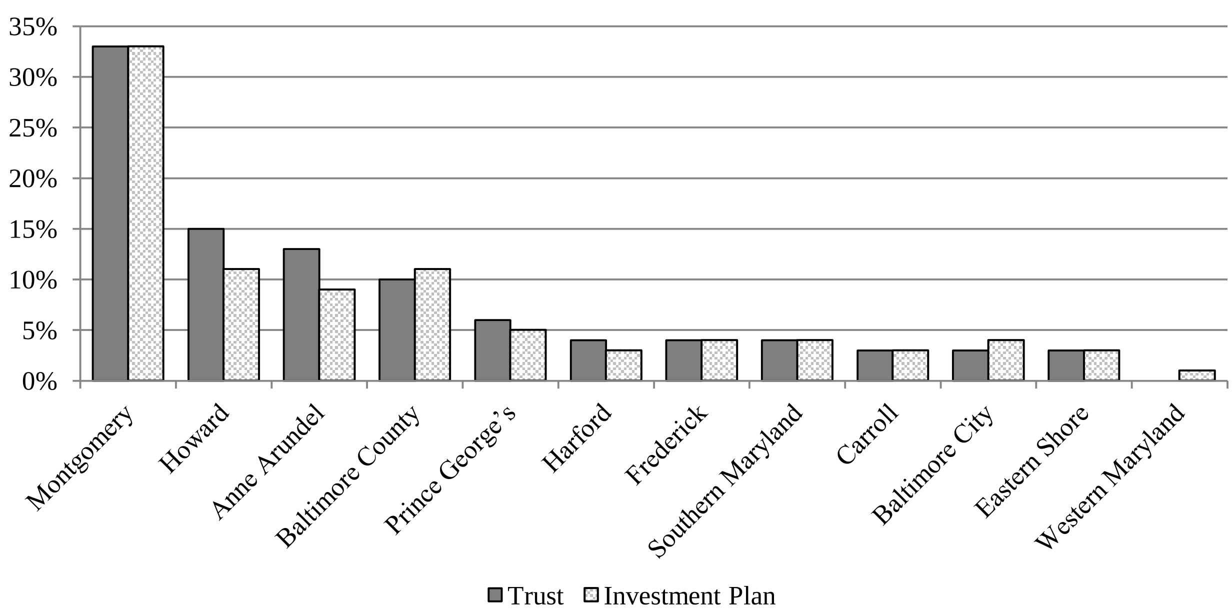
# *Issues*

## 1. Few Families Participate in 529 Plans

Not only are few families participating in 529 plans, but those who do tend to be wealthier than others according to a December 2012, U.S. Government Accountability Office (GAO) report entitled, *A Small Percentage of Families Save in 529 Plans*. States offer a variety of 529 plans, and as of July 2012, more than one hundred plan options were developed and managed by states and the District of Columbia. In 2011, there were more than 11 million accounts with total assets of $167 billion. According to the 2010 Survey of Consumer Finances, less than 3% of families had a 529 plan or Coverdells (a similar but less frequently used education savings account). These families had about 25 times the median financial assets and about three times the median income as those who did not participate in a 529 plan, $142,400 per year compared to $45,100 per year.

This trend holds true in Maryland in which the highest percentage of new account holders reside in those counties with higher median incomes. As shown in **Exhibit 4**, Montgomery County residents account for 33% of the new enrollments in both the trust and investment plans.

**Exhibit 4**
**Profile of New Prepaid College Trust and Investment Plan Enrollment by County/Region of Residence**
**Fiscal 2012**




Note: Prepaid Trust sums to 98% and Investment Plans totals 91% with the remaining 2% and 9%, respectively, of account holders residing outside of Maryland

Source: College Savings Plan of Maryland

The GAO identified various barriers families encounter when considering whether to save for college. These include insufficient income, underestimating the cost of college, and misconceptions about the availability of financial aid. A 2010 national survey conducted by Sallie Mae found that while 9 out of 10 parents expected their children to attend college, only about 3 out of 5 have saved or invested for their oldest child's education. Many families who want to save for their children's education are not even aware of 529 plans. It was reported among parents who are saving for college that almost half are unfamiliar with 529 plans and 4% never heard of these plans. Also, due to the number of plans and variations in investment options, those who want to use a 529 plan find it difficult to compare plans. Other factors that may limit participation include federal and state tax benefits that may not be as helpful to low-income families and the limit of only changing an investment option once a year. The report cites steps some states have taken to overcome these barriers, specifically for low-income families, such as adopting plans that include less risky investments, having low minimum contributions, and matching a family's contribution.

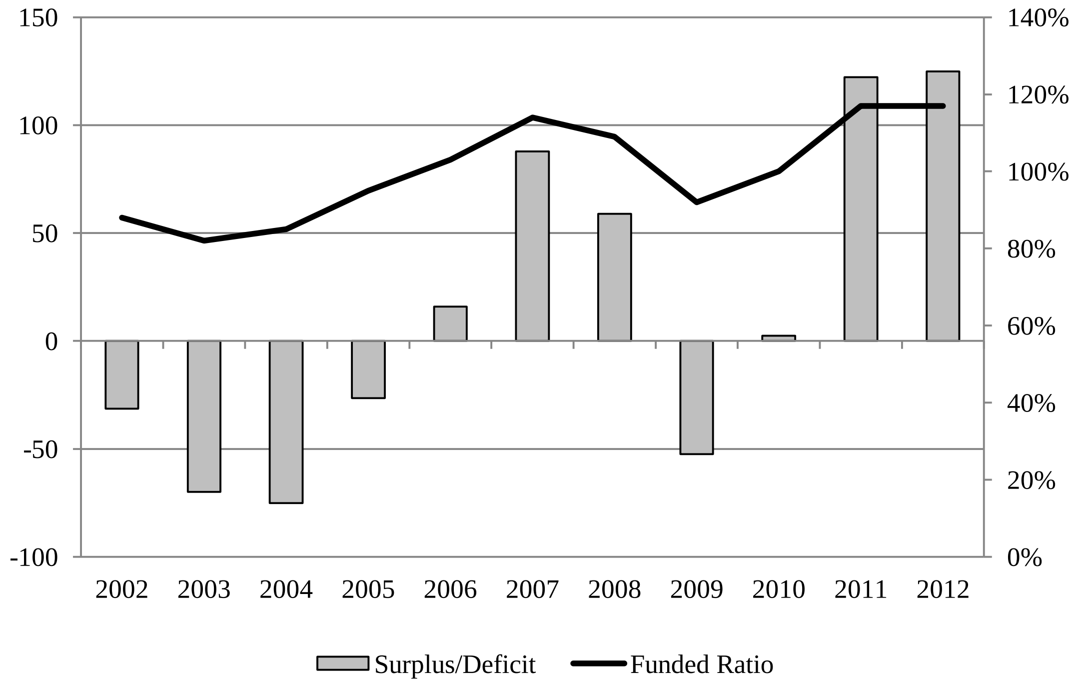
**CSPM should comment on its efforts to increase the awareness and participation of low-income families and what actions or initiatives could be undertaken at the State level.**

## 2. Actuarial Surplus Increases

The actuarial surpluses and deficits from 2002 to 2012 are shown in **Exhibit 5**. The surplus significantly increased from $2.5 million in fiscal 2010 to $122.3 million in fiscal 2011, when the trust was 117.0% funded. This growth was due to an overall return of 21.0% on the trust's investments compared to 7.65% return in fiscal 2010. However, due to a weaker return of 1.6% in fiscal 2012, the surplus slightly increased to $124.9 million, and the trust remained 117.0% funded. It should be noted according to statute if the surplus is 30.0% *e.g.*, 130.0% funded or more, then the board may provide a rebate to account holders. Investment declines in the trust have been somewhat tempered by the lower than projected increases in tuition and mandatory fees at the University System of Maryland. The increase in tuition at Maryland public colleges was 3.0% less than the projected tuition increase of 7.0%. Overall, Maryland compares favorably to other state prepaid plans, which, according the College Savings Plans Network, are on average about 93.0% funded.

**CPSM should comment on the overall actuarial surplus and if the assumptions used to determine contract prices should more accurately reflect tuition increases which since fiscal 2007 have either been frozen or increasing 3% a year.**

**Exhibit 5**
**Actuarial Surplus/Deficit as of June 30, 2002-2012**
**($ in Millions)**




Source: College Savings Plan of Maryland

## 3. Still No Brokerage Backed Plans

Chapter 548 of 2008 allowed CSPM to establish a Maryland Broker-Dealer College Investment Plan, effective October 1, 2008. This type of plan would allow Maryland families who invest through private investment advisors to participate in one of Maryland's college savings plans. In the previously mentioned GAO report, it was noted that one way families learn about 529 plans is through their financial advisors. Without this change, brokers do not have the incentive to direct clients to invest in one of the plans because participants enroll themselves directly in the program. Therefore, the broker does not receive a commission. As a result, brokers steer clients toward programs in other states managed by their investment firm or another firm that pays commission. To date, there has not been any progress toward establishing a brokerage plan.

**CSPM should comment on why a broker-dealer plan has yet to be established.**

# *Recommended Actions*

1. Nonbudgeted.

Appendix 1

# *Audit Findings*

| | |
|---|---|
| Audit Period for Last Audit: | February 9, 2009 – August 2, 2011 |
| Issue Date: | July 2012 |
| Number of Findings: | 2 |
| Number of Repeat Findings: | 0 |
| % of Repeat Findings: | 0% |
| Rating: (if applicable) | n/a |

***Finding 1:*** CSPM had not performed complete and timely bank reconciliations for the Maryland Prepaid College Trust.

***Finding 2:*** Lack of adequate controls over blank checks for the Trust.

**Object/Fund Difference Report**
**College Savings Plans of Maryland**

| Object/Fund | FY 12 Actual | FY 13 Working Appropriation | FY 14 Allowance | FY 13 - FY 14 Amount Change | Percent Change |
|---|---|---|---|---|---|
| **Positions** | | | | | |
| 01 Regular | 15.00 | 18.00 | 18.00 | 0.00 | 0% |
| **Total Positions** | **15.00** | **18.00** | **18.00** | **0.00** | **0%** |
| **Objects** | | | | | |
| 01 Salaries and Wages | $ 1,170,305 | $ 1,517,045 | $ 1,525,183 | $ 8,138 | 0.5% |
| 03 Communication | 70,866 | 152,000 | 156,560 | 4,560 | 3.0% |
| 04 Travel | 12,229 | 12,000 | 12,000 | 0 | 0% |
| 06 Fuel and Utilities | 6,234 | 4,000 | 4,000 | 0 | 0% |
| 07 Motor Vehicles | 5,194 | 9,460 | 9,460 | 0 | 0% |
| 08 Contractual Services | 759,981 | 1,041,887 | 1,073,338 | 31,451 | 3.0% |
| 09 Supplies and Materials | 34,586 | 35,078 | 36,130 | 1,052 | 3.0% |
| 11 Equipment – Additional | 27,344 | 27,500 | 97,500 | 70,000 | 254.5% |
| 13 Fixed Charges | 175,000 | 211,487 | 215,039 | 3,552 | 1.7% |
| **Total Objects** | **$ 2,261,739** | **$ 3,010,457** | **$ 3,129,210** | **$ 118,753** | **3.9%** |
| **Funds** | | | | | |
| 07 Nonbudgeted Fund | $ 2,261,739 | $ 3,010,457 | $ 3,129,210 | $ 118,753 | 3.9% |
| **Total Funds** | **$ 2,261,739** | **$ 3,010,457** | **$ 3,129,210** | **$ 118,753** | **3.9%** |

Note: The fiscal 2013 appropriation does not include deficiencies. The fiscal 2014 allowance does not include contingent reductions.

Appendix 2